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PUBLIC UTILITIES COMMISSION

[XX] Via Hand Delivery

March 10, 2010

The Honorable Chairman and Members of the
Hawaii Public Utilities Commission
Kekuanaoa Building
465 South King Street, Room 103
Honolulu, Hawaii 96813
Attn: Michael Azama, Esq.

Re: Docket No. 2009-0048 - Molokai Public Utilities, Inc. ("MPU")

Dear Chairman, Commissioners, and Commission Staff:

Pursuant to the Stipulated Regulatory Schedule attached to the Order Approving Proposed Procedural Order, as modified, filed November 6, 2009, the County of Maui submits its Statement of Probable Entitlement concerning the Amended Application for a rate increase filed by Molokai Public Utilities, Inc. on June 29, 2009.

I. INTRODUCTION

As an initial matter, the County of Maui believes MPU must provide additional information regarding expected water uses and customers in light of a recent arbitration decision. The County recently became aware of an arbitration award issued by the Honorable Patrick Y. Yim (Ret.) in which Judge Yim ordered Kaluakoi Poolside, LLC, a company affiliated with MPU and its parent company, Molokai Properties, Ltd. ("MPL"), to repair and reopen common areas and a swimming pool located at the Poolside (Hotel) developed by a predecessor of MPL. In its response to West Molokai Association's

Information Request 607, MPU reported that the Hotel was no longer a customer because it had shut down. All of MPU's projections relied on that assertion. The County is unsure as to the specific impact the arbitrator's decision could have on this water rate case. However, the County asks the Commission to seek information and a report from MPU concerning the impact reopening the common areas and pool may have on this case.[1]

In any event, the County respectfully submits that MPU is not entitled to the rate increase requested. MPU's losses and its purported inability to operate under prior or existing rates is a direct result of MPU's parent company's decision to withdraw its commercial operations from West Molokai. MPU is a subsidiary of MPL. During the 1970's, MPL embarked on an ambitious plan to develop West Molokai. There is no doubt that the water utility that is the subject of this rate making proceeding was designed and built to benefit MPL's commercial real estate development plans. Now that MPL has ceased operating, the remaining rate payers (i.e., the County and residents of West Molokai) should not be forced to make up the difference and pay for a utility service that was built to benefit MPL and its commercial operations.

Secondly, MPU was required to monitor water, to report to the Commission, and to avoid water loss. The Commission so ordered MPU to report to the Commission in MPU's prior rate proceeding in 2003. It appears MPU has not taken appropriate measures to monitor and repair the water loss. Therefore, the limited number of rate payers remaining in West Molokai should not have to bear the costs of wasted water. The Commission should make appropriate adjustments to ensure that the remaining rate payers are not forced to pay for water service meant for MPL and do not bear the burden of paying for wasted water.

II. BACKGROUND

On June 29, 2009, MPU filed an Amended Application requesting, among other things, a revenue increase of over 201% above present revenues. On September 11, 2009, the County of Maui timely filed a motion to intervene,

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[1] A copy of the Partial Final Award of Arbitrator is attached as Exhibit A.

which the Commission granted on October 16, 2009.[2] On November 6, 2009, the Commission entered an Order Approving Proposed Procedural Order, as Modified, which attached as Exhibit "A" a Stipulated Regulatory Schedule.

According to the Stipulated Regulatory Schedule, the parties must file simultaneous Statements of Probable Entitlement on March 10, 2010 "if no Settlement Pre Hearing Conference." Also according to the Regulatory Schedule and pursuant to HRS § 269-16(d), the Commission is required to issue an Interim Decision and Order concerning the rate relief requested by April 29, 2010, unless the Commission deems the evidentiary hearings incomplete, in which case the commission may postpone its interim rate decision for thirty days to May 29, 2010. By letter dated March 4, 2010, the Commission notified the parties that the pre-hearing conference is scheduled for April 27, 2010 at 9:30 a.m. and the evidentiary hearing is scheduled for May 11 through May 13, 2010.

III. DISCUSSION

A. General Principles Regarding Rate Making.

Section 269-16 of the *Hawaii Revised Statutes* authorizes the Commission to establish utility rates that are "just and reasonable." The governing principle underlying a "just and reasonable" rate is the right of the public on the one hand to be served at a reasonable charge, and the right of the utility to a fair return on the value of its property used in the service.

A return is deemed "fair" or "reasonable" if it produces a fair rate of return on the rate base. *In re Hawaii Electric Light Co., Inc.*, 60 Haw. 625, 632, 594 P.2d 612, 628 (1979). The determination of a proper rate base entails a valuation of the property of the utility devoted to public utility purposes on which the utility is allowed to earn an appropriate rate of return. *In re Puhi Sewer & Water Co., Inc.*, 83 Haw. 132, 137, 925 P.2d 302, 307 (1996); *see also, Honolulu Gas. Co. v. Public Utilities Comm'n*, 33 Haw. 487, 493 (1935) (rate base has been defined as "the present value, . . . of the property both tangible and intangible owned by the company used and useful in its utility operations. . .").

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[2] *See* Order Granting Intervention to the County of Maui, West Molokai Association, and Stand for Water, filed October 29, 2009.

The standard for determining a fair rate of return has been characterized by the Hawaii Supreme Court as "deceptively simple" and has been articulated as follows:

> There is no particular rate of compensation which must in all cases be regarded as fair earnings for capital invested in business enterprises. Locality, risks incurred and prevailing local rates on similar investments are all factors to be considered. Fair return is the percentage rate of earnings on the rate base allowed the utility after making provision for operating expenses, depreciation, taxes and other direct operating costs. . . . Fair return is something over and above the usual interest rate on well-secured loans to compensate for the risks and hazards of business and for the profits of management.

Id. at 636, 594 P.2d at 620 (quoting *Honolulu Gas Co. v. Public Utilities Commission*, 33 Haw.487, 518- 519 (1935)). The reasonableness of rates is not determined by a fixed formula, but is a fact question requiring the exercise of sound discretion by the Commission. *Id.*

Generally, regulatory commissions may consider a parent corporation's capital structure in setting an appropriate rate of return for a utility subsidiary. *See e.g., Hawaii Electric Light Co., Inc.*, 60 Haw. 625, 632, 594 P.2d 612, 628 (1979) (observing that when a parent owned all or virtually all the common stock of a subsidiary, the cost of equity to the subsidiary could only be reckoned on the basis of the cost of equity capital to the parent, and that most utility regulatory commissions had recognized this relationship between a corporate subsidiary and its parent). In other words, a regulatory commission may look through the corporate form of affiliated corporations and probe for economic realities. *See United Gas Pipe Line Co. v. Louisiana Public Service Comm'n*, 241 La. 687, 707, 130 So.2d 652, 660 (1961).

The general principle that the capital structure of a utility's parent corporation can be considered in determining the capital structure of the utility to arrive at an appropriate rate of return for the utility is codified in HRS § 269-16(e) which states:

> In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the State of Hawaii, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the commission may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among the organizations, trades or businesses, if it determines that the distribution, apportionment or allocation is necessary to adequately reflect the income of any such organizations, trades or businesses to carry out the regulatory duties imposed by this section.

It is with these general principles in mind that the County believes MPU is not entitled to the rate increase requested. Further, the County believes that it is well within the Commission's authority to impute the capital structure of MPU's parent company, MPL, to establish a fair and reasonable rate for MPU to charge its utility customers on Molokai.

B. The Rate Payers Should Not Be Forced to Pay for the Utilities' Excess Capacity as a Result of MPL's Withdrawal from Molokai.

MPL owns approximately 70,000 acres of land on the island of Molokai. During the 1970's, MPL and its predecessors sought to develop a large portion of its property located throughout West Molokai. Among the ambitious development plans by MPL that came to fruition were resort properties, a golf course, and various residential communities, as well as commercial properties.

As part of its real estate development plans, MPL designed and built water systems to provide water to its properties, including to resort properties and a golf course. Eventually, MPL created subsidiary utility companies, including MPU and Wai'ola O Molokai, Inc. (collectively, "Utilities"), to provide the water to its customers.

In approximately March 2008, MPL abruptly announced that it was ceasing its business operations, including closing Molokai Ranch. By the end of 2008, most, if not all, of MPL's business operations closed. On May 8, 2008, MPL announced that its Utilities could no longer afford to operate on Molokai and unless a third-party or a governmental entity (i.e., the County) took over

utility operations, there would be a shut-down in water and sewer service to West Molokai by the end of August 2008.

The Utilities and MPL cannot credibly dispute that the utility systems were designed and built largely to service MPL's ambitious commercial developments, including the resort properties and golf course. The Utilities and MPL also cannot credibly dispute that MPL's commercial operations were the largest consumers of water and, as a result of MPL's closure of its business operations, the Utilities are now left with oversized utilities or what is known as excessive capacity. Thus, the reason why the Utilities cannot afford to operate at prior or existing rates is because of MPL's withdrawal of its business operations on Molokai.

Further, in light of the recent arbitration decision requiring the reopening of common areas and a swimming pool at the Hotel, the impact of providing water to the Hotel is unknown because MPU's analysis considered did not factor in the Hotel as a water user.

It would be fundamentally unfair to impose substantial rate increases upon the remaining ratepayers following MPL's withdrawal of its commercial operations, especially when the utility systems were built primarily to benefit MPL's commercial developments. The Commission would be well within its authority to adjust the proposed rates to accommodate the excess capacity left by MPL closing its business operations on Molokai and to take into consideration the impact the arbitration decision will have on this case.

C. MPU Is Not Entitled to a Rate Increase When Issues Remain as to Excessive Water Loss.

The rate payers also should not be forced to pay substantially higher rates for water they do not consume. Specifically, there appears to be outstanding issues from MPU's prior rate case from nearly eight years ago (Docket No. 02-0371) where the Commission recognized discrepancies surrounding water loss from Well 17 and the amount of water consumed by the utility customers. Then, the Commission ordered MPU to "provide quarterly reports" to the Commission and the Consumer Advocate:

> . . . on the status of the upgrade of its facilities, scheduled to begin July 2003, including information

> on the progress of the construction of the new transmission facilities, and any other steps implemented by MPUI to reduce the amount of water loss and further upgrade its water system.

Decision and Order No. 20343 in Docket No. 02-0371 at 21.

MPU does not dispute that it has not been able to resolve the water loss issues. *See Rebuttal Testimony of Robert L. O Brien* at 18: 1 - 15 ("[MPU] . . . was not able to quantify the water used for treatment or have any data to support the sources of the other water losses").

Given that water loss issues continue to exist, the Commission should not approve MPU's requested rate increase and force rate payers to pay for lost water they do not consume.

D. The Commission Should Consider MPL's Capital Structure and Transactions Between MPL and its Utilities.

Given that there are discrepancies between MPU's accounting records and the consolidated tax returns of the parent company (e.g., allowable depreciation costs), the Utilities are not entitled to the relief requested and an evidentiary hearing is necessary to fully develop the record and to vet these issues and any other issues raised by the County, the Consumer Advocate, and West Molokai Association.

IV. CONCLUSION

The County of Maui respectfully submits that MPU is not entitled to the rate increases requested. The Commission should not allow MPU to charge utility customers substantially increased rates when the utilities were built largely to benefit MPL's ambitious development plans and MPL decided to cease operating on Molokai. MPL's withdrawal of its business operations on Molokai is the reason why MPU can no longer afford to operate at its prior rates. The rate payers should not be forced to make up the difference and pay higher rates because of MPL's business decision to abandon its commercial operations on Molokai. Further, the Commission should not make any decision concerning rates until the water loss issue raised in MPU's prior rate case has been properly and fully addressed by MPU and should not render a decision

until the discrepancies between MPL's tax return and MPU's accounting records are fully vetted.

Very truly yours,

Margery S. Bronster
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Attorneys for the County of Maui

Enclosure

cc: Michael H. Lau, Esq./Yvonne Y. Izu, Esq.
Consumer Advocate
Andrew V. Beaman, Esq.
William W. Milks, Esq.

DISPUTE PREVENTION & RESOLUTION, INC.
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Honolulu, Hawaii 96813
(808) 523-1234

Judge Patrick K.S.L. Yim (Ret.)
Arbitrator

THE ARBITRATION TRIBUNALS OF

DISPUTE PREVENTION & RESOLUTION

STATE OF HAWAII

In the matter of the Arbitration Between:	DPR Case No. 09-0091-A
THE WEST MOLOKAI RESORT ASSOCATION OF APARTMENT OWNERS	**PARTIAL FINAL AWARD OF ARBITRATOR**
Claimant,	
vs.	
KALUAKOI POOLSIDE, LLC	
Respondent.	

PARTIAL FINAL AWARD OF ARBITRATOR

INTRODUCTION

The Parties in arbitration are the Claimant, THE WEST MOLOKAI RESORT ASSOCIATION OF APARTMENT OWNERS ("AOAO") represented by Terrance M. Revere, Esq., Kapono F. H. Kiakona, Esq., and Katie Lambert, Esq. of the firm of MOTOOKA YAMAMOTO & REVERE, and the Respondent KALUAKOI POOLSIDE, LLC, ("Respondent") represented by Andrew V. Beaman, Esq., Andrew W. Char, Esq., and Bethany C.K. Ace, Esq. of the firm of CHUN, KERR, DODD, BEAMAN & WONG.

EXHIBIT A

The arbitration hearing was conducted on July 27-28, 2009 at the offices of Dispute Prevention & Resolution, Inc. located at Pauahi Tower, 1003 Bishop Street, Suite 1155 in Honolulu, Hawaii. Upon the conclusion of the arbitration hearing, the parties submitted post-arbitration briefs. The record of arbitration was closed on October 22, 2009 upon the receipt of the Respondent's Reply Brief re: Respondent/Counterclaim Plaintiff Kaluakoi Poolside LLC's Post-Hearing Brief In Support of Counterclaim.

THE CONTROVERSY

This action was filed by the AOAO against the Respondent, and the AOAO alleges that the Respondent failed to abide by specific and unambiguous provisions of a Cross Easement Declaration ("CED") and First Amendment to Cross Easement Declaration (ACED") (collectively "Cross Easement Documents"). The AOAO seeks to enforce compliance of the Respondent to these provisions. The Respondent denies the allegations. The Respondent counterclaims that the AOAO owes it monies. The AOAO denies the counterclaim.

The Arbitrator, in granting in part the AOAO's Motion for Partial Summary Judgment on June 12, 2009, ruled that **(1) the Respondent has an obligation to maintain the Hotel Lot, and (2) the Respondent has an obligation to allow the AOAO access to the Hotel Lot common areas.**

On July 28, 2009, the Arbitrator, upon the request of the parties, participated in a site visit of the Hotel Lot and the Condominium Lot in the company of Jeff Kent, AOAO President, and Daniel Orodenker, Esq., Manager of Respondent Kaluakoi Poolside, LLC.

ISSUES

The following issues remains for determination by the Arbitrator

1. Has the Respondent fulfilled its obligation to maintain the Hotel Lot. NO
2. Has the Respondent precluded the AOAO's owners and guests from access to the common areas of the Hotel Lot. YES

3. Has the Respondent fulfilled its obligation to maintain the swimming pool on the Hotel Lot. NO
4. If the Plaintiff prevails on any of its claims, what remedy(ies) is/are the Plaintiff entitled.

Additionally, the Respondent has counterclaimed that the Plaintiff owes the Respondent more than $42,330.00 for past costs associated with the operation of the pool, and therefore is, itself, in default of the Cross Easement Documents. Further, the Respondent claims that it is owed monies also because the Hotel Lot is providing through its water meter and pipes water, for maintaining certain common areas on the Condominium Lot. The issues as to this counterclaim are:

5. Were the Respondent's answer and counterclaim timely asserted, and if not, should they be stricken and dismissed?
6. How much is owed by the AOAO to the Respondent.
7. Does the AOAO's failure to pay, assuming said is proven, constitute a breach and therefore a default of its obligations under the relevant provisions of the Cross Easement Documents.
8. Does the AOAO owe any monies to the Respondent for water being expended by the Respondent for maintaining the landscaping on certain areas of the Condominium Lot, and if so, how much.

FINDINGS AND CONCLUSIONS

Regarding the findings of fact, the Arbitrator carefully considered all of the evidence, including but not limited to, the totality of the exhibits, and the testimony of witnesses adduced in person and in deposition. In determining the credibility of any witness and the weight to be accorded the testimony of said witness, consideration was given to the internal consistency or lack thereof of said testimony, the internal consistency or lack thereof of said witness' corroborating witness(s), the witness' appearance and demeanor, degree of candor or frankness, interests in outcome, relationship to a particular party, temper, feeling or bias, character as shown by the evidence, means or opportunity to acquire information, probability or improbability of the testimony.

Based upon careful consideration of the totality of the evidence adduced, the Arbitrator finds and concludes as follows:

1. In April 1976, Kepuhi Partnership ("Kepuhi") a Hawaii Joint Venture, as owner of two adjacent lots on Molokai which it wanted to develop, recorded a Cross Easement Declaration ("CED") on title to both of the Lots and filed same in the Land Court of the State of Hawaii, creating easements over each lot that ran in favor of the owner(s) of the other lot.
2. Thereafter it developed a condominium apartment project on one of the lots ("Condominium Lot") and a resort hotel on the other lot ("Hotel Lot").
3. Regardless of the fact that at the time the CED was executed and that both Lots had been unimproved, it is undisputed that Kepuhi intended to develop a condominium apartment project on the Condominium Lot and a resort hotel on the Hotel Lot, and wished to create easements over each lot that would run in favor of the owners of the other lot.
4. At that time, the plain language of the CED is clear and unambiguous that the owners intended that the resort hotel and condominium project for the Lots would continue in existence, unless and until agreed in writing.
5. There is no language contained in the CED that the Declarant vested discretionary power in the hands of the Hotel Lot Owner to unilaterally change any of its duties and obligations under the CED.
6. There is no language in the CED that supports the Respondent's assertion that it fulfills its duties and obligations to maintain certain common elements if it merely takes reasonable steps to eliminate unreasonable risks of harm posed to persons using its property, or to warn users of such risks of harm.
7. Regarding the grant of cross easements, the CED provides:

   "2. Grant of Cross Easements. The owners of each Lot, their employees, agents, servants, customers, tenants, guests and invitees shall have the same rights to use the common areas of the other Lot as they have with respect to the Lot which they own, including, without limitation, rights of ingress and egress over all roadways and pathways leading to the beach, golf course and swimming pool."

8. In 1987, Kukui purchased from Kepuhi the Kaluakoi Hotel which was built on the Hotel Lot.

9. As part of that purchase, Kukui received an assignment of Kepuhi's rights and obligations under the CED in an unrecorded assignment dated November 24, 1987.

10. Ensuing from a suit filed in 1994 by Kukui against the AOAO, the parties executed the SETTLEMENT, RELEASE AND COVENANT-NOT-TO SUE AGREEMENT ("SRCA") dated May 1, 1996, in pertinent parts (a) restates Kukui's responsibility for maintaining certain common areas of the Lots and requires the AOAO to reimburse it "... for a certain share of the Cost of Common Area Maintenance as defined in the CED.", (b) sets forth the terms of the settlement of the action which precipitated the signing of this document, and (c) requires that the parties amend the CED by executing and recording a First Amendment to the CED. The SRCA did not relieve Kukui of its obligation to maintain certain common areas of the Hotel Lot.

11. Also on May 1, 1996 in compliance with the SRCA, Kukui and the AOAO entered into the First Amendment to Cross Easement Declaration ("FACED").

12. The First Amendment to Cross Easement Declaration, ("FACED") in pertinent parts, pronounces that the AOAO would be required to maintain the cost of maintenance and repair of "...any building, real property taxes, principal and interest on any mortgage indebtedness, any capital improvement, the cost of gardening, landscaping, replanting, re-landscaping, refuse removal, directional signs and markers, purchase and maintenance of refuse containers, grounds keeping, tree-trimming, pest control treatment services and repairs to lighting fixtures and equipment..." which functions the AOAO shall perform for the Condominium Lot and Kukui to perform for the Hotel Lot. The FACED recites that "... In all other respects, the CED shall remain in full force and effect as amended in this Amendment."

13. There is no provision in the FACED relieving Kukui of its obligations to provide to the owners of the Condominium Lot the right to use the common areas of the Hotel Lot.

14. There is no provision in the FACED relieving Kukui of its obligations to maintain the common areas on the Hotel Lot as described in paragraph 1 of the CED wherein appears the definition of "Cost of Common Area Maintenance."

15. In June 2000, when Kukui closed the Hotel operations, it continued to maintain the Hotel's common areas, including the swimming pool.

16. Kukui's obligation to maintain certain common areas and the swimming pool on the Hotel Lot remained unchanged.

17. In early 2002, Kukui sold the Hotel to its successor Molokai Properties Limited ("MPL"), which, like its predecessor, Kukui, continued to maintain the Hotel's common areas and the swimming pool.

18. MPL's duties and obligations to maintain the Hotel Lot's common areas and swimming pool remained unchanged.

19. In late 2008, MPL announced that it would discontinue all of its operations on Molokai, including the Hotel related operations, including the level of maintenance of the Hotel's common areas which it previously provided. Shortly thereafter, MPL discontinued the operations.

20. The Respondent is the successor in interest to Kopuhi, Kukui, and MPL.

21. The Respondent's obligations to maintain certain common areas of the Hotel Lot remained unchanged, regardless of its announcement and the reasons therefore.

22. In regards to the issue of cost of maintenance of certain common areas, both the AOAO and the Respondent are required to abide by each and every term and condition contained in the Cross Easement Documents.

23. Consistent with the applicable and relevant provisions of the CED, the rulings of the Arbitrator on June 12, 2009, ".. inure to the benefit of and [are] binding upon the heirs, executors, administrators, successors and assigns of such persons."

24. From the time of the execution of the CED, the parties intended for the integrated common usage complex, consisting of the Hotel Lot and the Condominium Lot.

25. There is no language in the totality of the Cross Easement Documents that Kukui and its successor in interest, the Respondent, has the duty and obligation to maintain the Hotel Lot for the integrated use of both the Condominium Lot and the Hotel Lot for only so long as there is a ongoing hotel operation on the Hotel Lot.

26. All the easements and covenants and conditions set forth in the CED run with the two Lots and are binding on both the Plaintiff, including the owners of apartments on the

Condominium Lot, the Respondent, and the parties' heirs, executors, administrators, successors and assigns.

27. Though the Cross Easement Documents may allow the parties to determine how much they each will spend on labor and materials to maintain their respective Lots, there is no language that relieves any party of the obligation to maintain their respective Lots consistent with the intention expressed in the original CED.

28. There is no language in the Cross Easement Documents that allows the owner of the Hotel Lot, if it decides to discontinue resort hotel operations, to be relieved of its duties and obligations to maintain the pool and common elements as described in those Documents.

29. Therefore, despite its protestations to the contrary, the Respondent's discontinuance of the use of the improvements on the Hotel Lot as a resort is irrelevant to its maintenance obligations as described in the Cross Easement Documents.

30. Per Paragraph 9 of the CED, the Plaintiff and the Respondent may amend the Declaration only in writing executed and acknowledged by the owner of the Hotel Lot and the Board of Directors of the AOAO.

31. The Amendment to Cross Easement Declaration specifically sets forth in paragraph 2.2, the "cost of common area maintenance" and the items to be included in that definition, which are to be shared between the parties herein.

32. The Amendment pronounces that the parties will cooperate in separate metering of water, and the resurfacing and repainting of the parking areas and roads on both Lots as needed, with each party bearing the cost of same as allocated by the contractor hired to perform such work. Additionally, paragraph 2.3 provides that the appropriate ratio for the apportionment of Cost of Common Area Maintenance as of April 1, 1996, is 55.75% to the Hotel Lot and 44.25% to the Condominium Lot.

33. At no time leading up to, or contemporaneous with the signing the of FACED did Respondent's predecessor in interest, Kukui, dispute its responsibility to preserve, maintain and care for the gardening, landscaping, replanting, re-landscaping, refuse removal, directional signs and markers, purchase and maintenance of refuse containers, grounds keeping, tree-trimming, pest control treatment services and repairs to lighting fixtures and equipment for the Hotel Lot.

34. The Respondent has failed to provide any evidence that the Cross Easement Documents have been amended further in any writing, executed and acknowledged by Respondent and the Board of Directors of the AOAO.

35. The original intention of the parties in entering into the CED was in "... furtherance of a plan for the integrated use of the two Lots and for the purpose of enhancing and perfecting the value, desirability and usability of the two Lots."

36. The "common areas' of each lot are defined in paragraph 1 of the CED.

37. The present level of maintenance by the Respondent of the common elements is not in accordance with the Cross Easement Documents.

38. Accepting *arguendo* that the present condition of the common areas is presently the same as it was at the time Mr. Peter Nicholas arrived in 2002, there is no evidence that the AOAO had agreed to accept that level of maintenance of said common areas as complying with the CED.

39. The fact that the AOAO declined to accept the Respondent's offer to allow the AOAO to take over maintenance of the Hotel Lot, while the Respondent would continue to pay its 55.75% share of common maintenance, does not relieve the Respondent from its duty and obligation to maintain the common areas.

40. Accepting *arguendo* the Respondent's argument that the AOAO President, Jeff Kent, actions on behalf of the AOAO against the Respondent are personally motivated, there is no evidence that he is pursuing these claims without the approval of the AOAO Board of Directors.

41. Accepting *arguendo* the Respondent's argument that the AOAO President, Jeff Kent's actions on behalf of the AOAO against the Respondent are personally motivated, there is no evidence that said motives relieve the Respondent of it duty and obligation under the CED to maintain the common areas.

SWIMMING POOL

1. Regarding the swimming pool, it is included as one of the elements of common areas on the Hotel Lot to be maintained by the Respondent under the CED.

2. Although the Respondent maintains that the State of Hawaii Department of Health effectively required that the Respondent close down the pool, the evidence, in fact, shows that the Department of Health, after inspecting and documenting the condition of the pool, and warning the Respondent of the need to keep the pool in compliance with the applicable administrative rules, did not force closure of the pool.

3. Further, the condition of the pool when inspected by the State Department of Health, and thereafter, was due solely to the conduct of the Respondent in its failure to maintain the pool in accordance with the Cross Easement Documents.

4. The Respondent's choice to shut the pool down was made despite the AOAO's obligation to share in the swimming pool's maintenance.

5. The AOAO is required to reimburse the Respondent 44.25% of the expenses to bring the pool in compliance with the applicable Department of Health rules governing pool.

6. The voluntary closure of the pool does not relieve the Respondent of its duties and obligations to comply with the CED and maintain the pool.

7. There is no evidence that any governmental body or agency required the Respondent to shut down the swimming pool.

8. Assuming *arguendo* that the rules and regulations of the State of Hawaii Department of Health, certain Federal regulations and certain SMA governing the instant swimming pool may preclude the ongoing use of this pool as it is presently equipped, the Respondent's decision not to incur the expenses of bringing it in compliance does not relieve it of its duties and obligations to maintain the pool.

9. Though the Respondent argues that it cannot be compelled to operate the pool in violation of any laws, rules or regulations, the Cross Easement Documents require that the Respondent bring the pool into compliance.

10. The Arbitrator has the authority to require the Respondent to bring the swimming pool into compliance with any laws, rules and regulations applicable thereto.

11. The Respondent's decision to shut down the pool was in violation of the Respondent's duties and obligation under the Cross Easement Documents.

12. The Respondent has failed to produce any evidence that it is legally impossible to bring the swimming pool into compliance.

13. The fact that the Respondent may be compelled to spend monies to bring the swimming pool in compliance before reopening does not constitute a legal impossibility and does not relieve the Respondent of its duties and obligations.

14. Though the Respondent may encounter an expense and inconvenience in reopening the pool, the Respondent has failed to produce any evidence that reopening the pool is a legal impossibility.

15. The Respondent is not relieved of its duties and obligations to maintain the pool for the use of the Condominium Lot.

16. Said closure is in direct violation of the Respondent's duties and obligations under the Cross Easement Documents.

17. To date, the Respondent refuses to reopen the pool.

18. The Respondent was neither ordered to nor compelled by any action of the State of Hawaii, Department of Health, or any Department of the United States of America to close the swimming pool.

19. The Respondent did so voluntarily.

20. Though the CED require that, upon timely notice by the Respondent, the AOAO shall pay its 44.25% of the estimated costs of same, the AOAO is relieved from making any contributions to the costs of maintenance regarding the pool, until the Respondent reopens the pool.

21. The Cross Easement Documents fo not require that the AOAO's accept the Respondent's offer use its own funds to front the costs of repair of the pool, and thereafter, obtain reimbursement from the Respondent for 55.75% of thereof.

22. The Respondent breached the pertinent provisions of the CED in regards to the pool.

23. The word "maintain" or "maintenance" is accorded any and/or all of the following meanings: keep in good order, keep in proper condition, keep in repair, preserve, or keep in a given existing condition, care for property for purposes of operation productivity or appearance, to engage in general repair and upkeep, to prevent a decline, to keep in existence or continuance, preserve, retain.

24. The Respondent's actual usage of the Hotel Lot is irrelevant to its maintenance obligations.

25. Despite this Complaint being the AOAO's first and only effort to utilize judicial or quasi-judicial means to secure a determination that the Respondent has failed to fulfill its maintenance obligation under the Cross Easement Documents, said delay is not deemed to be a waiver of the AOAO's rights to enforce the applicable provisions of the CED against the Respondent.

26. The AOAO has satisfied, by a preponderance of the evidence, that the Respondent has failed to fulfill its duties and obligations under the Cross Easement Documents to maintain the swimming pool on the Hotel Lot.

GROUNDS

1. The preceding discussion and findings as to the Respondent's duties and obligations regarding the maintenance of the swimming pool are equally applicable to the Hotel Lot walkways and landscaping.
2. Paragraph 1 of the CED recites as follows: "The 'Common Areas' of either Lot shall mean the entire Lot, exclusive of all buildings, including all parking areas, roads, walkways and landscaped areas, and with respect to the Hotel Lot they shall include the swimming pool...."
3. Some of the photographs in evidence depicted the manner in which the Hotel Lot's walkways and landscaped were maintained during the time the Hotel Lot was used as a resort.
4. It is a specific finding and determination that these photographs establish the standard for the maintenance of these elements of the common areas.
5. It is this established standard of maintenance of the walkways and landscaping which the Respondent must abide by to be in compliance with its duties and obligations under the Cross Easement Documents.
6. The remaining photographs in evidence depict the present state resulting from the Respondent's neglect and lack of care and maintenance of the Hotel Lot's walkways and landscaping on the Hotel Lot.

7. The AOAO has satisfied its burden of proof that the Respondent has failed to maintain the common areas walkways and landscaping on the Hotel Lot as required in the Cross Easement Documents.

8. The AOAO has satisfied, by a preponderance of the evidence, its burden of proof that the Respondent has failed to fulfill its obligations under the CED to maintain the common areas on the Hotel Lot.

9. The Arbitrator also adopts, and incorporates by reference herein as the minimum standard for the actual physical maintenance of the common areas, the instructions transmitted to the Respondent's staff as described by Daniel Orodenker in his June 9, 2008 email to Yolanda Reyes and Raymond K. Hiro, with a copy to Peter Nicolas regarding "Maintenance at Kaluako'i."

10. Since there is no evidence to the contrary, the Arbitrator finds that Orodenker's instructions were ratified by the Respondent's higher management and establishes a reasonable standard for said maintenance of the Hotel Lot's walkways and landscaping, including the swimming pool.

11. The Respondent has neither abided by nor adhered to these standards in the maintenance of the pertinent common areas on the Hotel Lot.

12. The Respondent failed to provide any logs, supported with photographs, which it instructed its employees to keep regarding work done in compliance with said email.

13. The Respondent breached its duties and obligations to properly maintain the Hotel Lot.

14. The Respondent has violated its obligation to allow users of the Condominium Lot access to the Hotel Lot common areas, including the pool.

15. As to any damages suffered by the AOAO and its members as a result of the Respondent knowing and intentional breach of its duties and obligations to maintain certain common areas on the Hotel Lot, including but not limited to the swimming pool, the testimony as to damages was general and anecdotal, and lacking in specifics. There was no specific information as to the number of cancellations directly resulting from the Respondent's breach of the CEDocuments.

16. The AOAO has not satisfied its burden of proof as to this claim.

COUNTERCLAIMS

1. As to the Respondent's counterclaim, the following is the procedural history of this litigation:
    i. The AOAO filed its complaint with the Second Circuit Court, State of Hawaii on February 17, 2009.
    ii. Thereafter the parties agreed to submit the claims in the complaint to binding arbitration and stay the court case.
    iii. The Respondent did not file an answer with the Second Circuit Court.
    iv. April 1, 2009 was the effective date of the arbitration agreement
    v. On July 20, 2009, the Respondent filed its Answer to Complaint and Counterclaim
2. Pursuant to DPR's Arbitration Rule No. 17, the Respondent had fourteen calendar days following DPR's receipt of a demand or claim to file a counterclaim.
3. The Respondent's counterclaim was filed with the tribunal on July 20, 2009 together with its Answer to the Movant's Complaint which was filed on February 17, 2009.
4. Though the Respondent's Answer and Counterclaim appears to be untimely, and therefore, should be dismissed, the Arbitrator declines to dismiss, and, instead, will consider the counterclaim on its merits.
5. Paragraph 4 of the CED, unchanged by any subsequent easement documents, addresses the annual adjustment and reads as follows;

    "Within thirty (30) days after the end of each calendar year, Kepuhi shall furnish to the owner of the Hotel Lot and the Board of Directors of the Association of Apartment Owners of the Condominium Lot ("Board of Directors") a statement confirming the actual expenditures of common areas maintenance. If the amount paid by the owners of either Lot for such year exceeds the total amount of common area maintenance costs required to be paid by such owners during such year, such overpayment shall be refunded in cash. If the amount paid by an owner for such year is less than the total amount for common area maintenance costs required to be paid by the owner during such year, the owner shall pay the deficiency within thirty (30) days after notice of the deficiency."

6. This provision that Kepuhi furnish the owner of the Hotel Lot a statement confirming the actual expenditures for common area maintenance "...thirty (30) days after the end of each calendar year..." was intended to allow the AOAO sufficient opportunity to establish the budget for the AOAO and assess the apartment owners their respective share of these costs pursuant to the Condominium Law, Chapter 514B of the Hawaii Revised Statutes.

7. After the May 1, 1996 First Amendment to Cross Settlement Agreement was signed by the parties in which the AOAO was to pay 44.25% and the Respondent 55.75% of the cost of common maintenance, the Respondent failed to adjust the monthly maintenance charges.

8. It was only in late 2007, that the Respondent discovered its failure to adjust the AOAO's share of the cost of common maintenance.

9. Though Dennis Ikeda, the controller of Molokai Properties testified that he calculated the AOAO's arrearages between 2005 and 2007 to be $42,330.00, he testified that said amount was less than due, since the Respondent elected to forebear seeking reimbursement of the increased insurance premium costs incurred. He testified that had the AOAO been charged its full pro-rata share of the maintenance costs, the total arrearages would have been approximately $76,000.00.

10. However, the Respondent's failure to timely furnish said information to the AOAO, has precluded the AOAO from properly assessing the proper apartment owners their respective share of these costs.

11. The Respondent's failure to timely furnish said information of its share of the maintenance costs to the AOAO made it impossible for the AOAO to attribute said pro-rata charges retroactively to the proper apartment owners.

12. This impossibility reasonably explains the statement of the Respondent's controller's recommendation that the Respondent "not pursue getting retroactive reimbursement for the three years that we failed to adjust the monthly billing as per the agreement."

13. The Respondent's failure to timely furnish said information to the AOAO constitutes a waiver of these charges.

14. Additionally, in the Respondent's zeal to support its counterclaim, it, despite having closed the pool in late December 2008 and announcing that it had no intentions of

reopening the pool and maintaining the other common areas in any other manner than what it had since the closing of the hotel, claims that the AOAO's share of common maintenance charges for the months of March 2009 through July 2009, including pool maintenance, totals $19,465.00.

15. On August 10, 2009, the Respondent also sent to the AOAO a letter advising of the common maintenance charges for fiscal year 2010 to be a monthly amount of $4,175.24 representing pool maintenance and labor, electricity, water, pool insurance, administrative fees, etc.

16. However, the Respondent failed to present adequate and reliable backup to support this determination and calculation of the monthly amount.

17. There is no evidence that the Respondent provided to the AOAO any information supporting the total amount from which was calculated the AOAO's share of the common maintenance costs.

18. As to the Respondent's claim that the AOAO contribute towards the costs the Respondent expended to water certain common areas of the Condominium Lot, both parties presented testimony supporting their respective positions on this issue. The AOAO presented evidence of its own survey that none of its common areas are watered by Respondent's metered pipes, and the Respondent's evidence indicating to the contrary.

19. The Respondent has the burden of proof as to this claim, and has not satisfied said burden.

20. The Movant is determined to be the prevailing because a) it initiated the arbitration; b) its claims inured to the benefit of both the Hotel Lot and the Condominium Lot, c) the Respondent's claim was raised as a counter-strike to the primary claims, e) in the history of the Respondent's claim, it was not forthcoming and candid in providing the Movant with substantive, consistent and accurate backup for its claim, which precluded the Movant from reasonably assessing the credibility and accuracy of said claim for monies, which the Movant is required to assess in such a manner in fulfillment of its fiduciary duty to the apartment owners.

21. All of the Respondent's defenses are found to be unproven and therefore dismissed.

22. The Respondent's failure to abide by its obligations to the AOAO as set forth above were knowing and intentional.

23. Said violations by the Respondent of its obligations were intentional, knowing, egregious and malicious.

24. Therefore, the AOAO is entitled to punitive damages.

25. The AOAO is the prevailing party.

26. The Respondent's obligations, which are found above to have been violated, are contractual obligations.

27. Therefore pursuant to Hawaii Revised Statutes Section 607-14, the AOAO, as the prevailing party is entitled to an award of its attorney's fees and costs.

28. The evidence presented is that some of the AOAO owners utilize their apartments as vacation rentals.

29. The evidence presented is that these owners have suffered loss of rental income due to the failure of the Respondent to maintain the Hotel Lot's common areas, including the pool.

30. However, the evidence presented is not sufficient so as to enable the Arbitrator to calculate loss rental damages as a consequence of the Respondent's breach of the Cross Easement Documents.

AWARD

Based upon careful consideration of the totality of the evidence adduced and the findings and conclusions set forth above, the Arbitrator AWARDS as follows:

A. The Respondent's counterclaims are dismissed.

B. The Respondent shall restore the entire Hotel Lot common areas to their prior condition.

C. Because the Respondent intentionally allowed the common areas to deteriorate, it alone shall bear the costs of restoring all of the Hotel Lot's common areas to their prior condition. Only after such a restoration has occurred to the standard set forth

above shall the AOAO be required to bear its share of maintenance of the restored common areas.

D. Specifically, the Respondent shall forthwith commence to repair and reopen the swimming pool.

E. Only after the pool is restored to the condition in which it was prior to the Respondent abandoning the pool's care and maintenance prior to the pool's closure, shall the AOAO be required to bear its percentage share of maintaining and renovating said pool to comply with standards as shall be ordered by governmental authorities in writing.

F. The AOAO is awarded, and the Respondent shall pay, punitive damages in the amount of $75,000.00, said amount to be paid in full within 30 days of the date of this Partial Final Award. If said amount is not paid in full as set forth above, any remaining balance due the AOAO shall bear interest in the amount of 10% simple per annum.

G. In light of the finding that the AOAO is the prevailing party in its breach of contract claims, the Respondent shall pay the AOAO as and for attorney's fees and costs as allowed in Hawaii Revised Statutes Section 607-14.

H. The Arbitrator retains jurisdiction solely to award reasonable attorney's fees and costs as provided by law.

I. The AOAO shall file with the Arbitrator, with a copy to the Respondent, within 30 days of the date of this PARTIAL FINAL AWARD OF ARBITRATOR, a particularized declaration setting forth therein all necessary and customary information to support its claim for the award of its attorney's fee and costs.

J. Thereafter, the Respondent shall, within 15 days of the date of the AOAO's declaration, submit to the Arbitrator, with a copy to the AOAO, its particularized objections to the AOAO's claim for an award of attorney's fees and costs.

K. Thereafter, the Arbitrator will issue the FINAL AWARD OF ARBITRATION.

So AWARDED this 24th day of December, 2009.

/s/

Judge Patrick K.S.L. Yim (Ret.)
Arbitrator

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Judge Patrick K.S.L. Yim (Ret.)
Arbitrator